Docket No. 12-0544
Staff RBOE

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

ILLINOIS POWER AGENCY Petition for Approval of the 220 ILCS 5/16-111.5(d) Procurement Plan	: : : :	**Docket No. 12-0544**

STAFF OF THE ILLINOIS COMMERCE COMMISSION

REPLY BRIEF ON EXCEPTIONS

JESSICA L. CARDONI
JOHN C. FEELEY
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
Fax: (312) 793-1556
jcardoni@icc.illinois.gov
jfeeley@icc.illinois.gov

Counsel for the Staff of the Illinois Commerce Commission

November 29, 2012

Table of Contents

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS POWER AGENCY **Petition for Approval of the 220 ILCS 5/16-111.5(d) Procurement Plan**	: : : :	**Docket No. 12-0544**

STAFF OF THE ILLINOIS COMMERCE COMMISSION
REPLY BRIEF ON EXCEPTIONS

The Staff of the Illinois Commerce Commission ("Staff"), by and through its counsel, and pursuant to Section 200.830 of the Commission's Rules of Practice (83 Ill. Adm. Code 200.830), respectfully submits its Reply Brief on Exceptions ("RBOE") in the above-captioned matter.

I. BACKGROUND

On September 28, 2012, the Illinois Power Agency ("IPA") filed its Final Power Procurement Plan ("Plan") with the Illinois Commerce Commission ("Commission"), thereby initiating this docket. On October 3, 2012, pursuant to Section 16-111.5(d)(3) of the Public Utilities Act ("PUA") and an October 1, 2012 ruling by the Administrative Law Judge ("ALJ"), Staff and the following parties served on each other and filed objections/comments to the Plan: FutureGen Industrial Alliance, Inc. ("FutureGen"), the Illinois Coalition to Advance Renewable Energy ("I-CARE"), the Illinois Industrial Energy Consumers ("IIEC"), the Retail Energy Supply Association ("RESA"), Ameren Illinois Company ("Ameren Illinois", "Ameren" or "AIC"), Commonwealth Edison Company ("ComEd"), Environmental Law and Policy Center ("ELPC"), Exelon Generation

Company, LLC and Constellation New Energy ("Exelon"), Illinois Competitive Energy Association ("ICEA"), Wind on the Wires ("WOW") and C3, Inc. d/b/a C3 Energy (“C3 Energy”). On October 10, 2012, the Chief ALJ of the Commission provided notice that, “pursuant to Section 16-111.5(d)(3) of the Public Utilities Act, no hearing in the above-referenced matter is determined to be necessary.” Pursuant to an October 4, 2012 ALJ Ruling, various parties filed responses to objections on October 15, 2012 and replies to responses on October 22, 2012.

On November 14, 2012, the ALJ issued a Proposed Order (“ALJPO”). The ALJ set November 21, 2012 and November 29, 2012 for the filing of exceptions and reply exceptions, respectively. Staff, IPA, ComEd, Ameren, FutureGen, ELPC, WOW, I-CARE, the Coalition of Energy Suppliers (“CES”) and the Natural Resources Defense Counsel (“NRDC”) filed Briefs on Exception (“BOEs”) on November 21, 2012. The lack of a reply by Staff to a particular exception filed by a party or parties should not be construed to mean that Staff agrees with the exception. In those instances where no reply is provided in the RBOE, Staff stands by the positions taken in its prior filings in this docket. Staff’s Reply Brief on Exceptions follows.

II. ARGUMENT

A. Staff’s Response to IPA and FutureGen

FutureGen argues that the ALJPO ignores the “mandate” “that 25% of the electricity used in the state shall be generated by cost-effective clean coal facilities.” (FutureGen BOE, pp. 3-4) Similarly the IPA argues that “there is a clear mandate by the Illinois Legislature that the Utilities and ARES procure electricity that is generated using clean coal." (IPA BOE, pp. 6-7) It is this "mandate" which FutureGen and the IPA rely upon in part to support their arguments for approval of the FutureGen sourcing agreement. However, the Legislature did not create a twenty-five percent "mandate"; it created a twenty-five percent "goal." Despite FutureGen's arguments to the contrary, the ALJ did not ignore this twenty-five percent goal as evidenced by the fact that the ALJPO states "It is the goal of the State that by January 1, 2025, 25% of the electricity used in the State shall be generated by cost-effective clean coal facilities." (ALJPO, p. 220, quoting 20 ILCS 3 885/l-75(d)(1)).

B. Staff's Response to FutureGen

FutureGen recommends the Commission approve a hypothetical 55% debt / 45% equity capital structure, a formulaic cost of debt that equals approximately 7% and an arbitrary 10% rate of return on equity ("ROE"), as set forth in Section 5.2(b) of FutureGen's proposed sourcing agreement. (FutureGen BOE, pp. 22-23; FutureGen Exceptions to the ALJPO, Section VIII.J.7) FutureGen's BOE fails to address the numerous problems Staff has identified regarding Section 5.2(b) of FutureGen's proposed sourcing agreement. (Staff Objections, pp. 30-38; Staff Response to Objections, pp. 16-17; Staff Reply, pp. 11-21; ALJPO pp. 133-135 and 144-147) For the sake of brevity, Staff will not repeat those facts and arguments here. However, Staff relies on those facts and arguments to support its recommendation that the Commission reject FutureGen's Exceptions pertaining to the regulatory review and approval of an appropriate rate of return for the project. Specifically, the Commission should not approve or adopt Section 5.2(b) of FutureGen's proposed sourcing agreement.

FutureGen proposes that the Commission authorize a hypothetical capital structure and arbitrary costs for debt and equity capital. (FutureGen BOE, pp. 22-23; FutureGen Exceptions to the ALJPO, Section VIII.J.7) In contrast, Staff proposes that the Commission authorize a rate of return that is based on the actual capital structure, cost of debt, and an appropriate ROE, including any ratemaking adjustments for prudence and reasonableness, within the context of a ratemaking proceeding. (Staff Objections, pp. 35-37) Importantly, an appropriate ROE for the project cannot be determined until the risk of the project is examined, which can only occur once the sourcing agreement has been finalized. (Staff Reply, pp. 15-20; ALJPO, pp. 145-147) The ALJPO provides Staff's proposed replacement language for Section 5.2(b) of the sourcing agreement on pages 135-136.

Nonetheless, FutureGen does make some assertions regarding its ROE proposal that merit a further reply at this time. First, the FutureGen BOE states, "[c]ounterparty (buyer) default…under the Sourcing Agreement is an additional risk to which utilities providing distribution service are typically exposed because they have the ability to seek recovery of their costs from their customers." (FutureGen BOE, p. 25) Staff explained that utilities procure power using a competitive procurement process that involves counterparties not regulated by the Commission. The costs a utility incurs when a counterparty defaults are audited, reported to the Commission, and subject to the same examination as all other costs recovered through the utilities' power purchase tariffs, to ensure those costs are reasonable. Nothing in the sourcing agreement suggests FutureGen would be subject to a different examination. (Staff Reply, pp. 16-17)

Second, the FutureGen BOE states, "[o]ther regulatory bodies have recognized that energy infrastructure projects with risk profiles similar to the FutureGen Project merit higher rates of return on equity…" (FutureGen BOE, p. 26) The FutureGen BOE states further:

> …in 2011, the IPA-commissioned study to recommend an appropriate return on equity for the Chicago Clean Energy synthetic natural gas project in which concluded that in both pending and completed rate cases, the mean and median authorized rates of return on equity for electric utilities, were well in excess of FutureGen's proposed rate of return on equity of 10%, and…the rate of return on equity requested by the Alliance is not inconsistent with those granted to Illinois utilities for new investment, such as Ameren's smart grid incentive return on equity of 10.05%.
>
> (FutureGen BOE, p. 26)

Ironically, despite a requirement in the Act that the Commission "shall … tak[e] into account the return on equity being received by developers of similar facilities in or outside of Illinois" (220ILCS 5/9-220(h-3)(1)(B), when determining the ROE, the IPA study that FutureGen cites above admitted that it could not identify "similar facilities." (Interim Order, Docket No. 11-0710, December 7, 2011, p. 3) Further, FutureGen fails to disclose that the 10% ROE described in the IPA study is an <u>expected</u> ROE, which depends on a combination of Chicago Clean Energy ("CCE") operating efficiency and market prices for natural gas, not the ROE that would be reflected in CCE's rates. In fact, the ROE that would be embedded in the cost of gas that CCE sells to utility customers is only 4.44%. (Interim Order, Docket No. 11-0710, December 7, 2011, p. 9) The IPA-proposed CCE sourcing agreement contains very complex revenue-sharing provisions in which CCE would have absorbed all construction costs and non-fuel O&M cost overruns – risks that FutureGen does not propose to fully accept. (Staff Reply, p. 20)

Third, Staff has already explained why the Ameren ROE would be inappropriate for FutureGen. (Staff Objections, pp. 33-34) Ameren's 10.05% smart grid incentive ROE is based on the EIMA formula, which served as the starting point for Staff's formula rate proposal in this proceeding, but which FutureGen opposed, stating: "That statute is hardly relevant for determining the appropriate rate of return on equity for financing a retrofitted power plant using first-of-kind technology." (FutureGen BOE, p. 24)

Nevertheless, despite the problems with FutureGen's rate of return proposal, and in recognition of the benefits associated with defining a lower boundary on the project's ROE within the sourcing agreement, Staff provided the Commission two alternative proposals for replacing Section 5.2(b), which would establish an ROE for the Project by either formula or a traditional ratemaking process. Both of those proposals would benefit equity investors by defining a lower boundary on the authorized ROE, while recognizing that the final Commission-authorized rate of return should consider the actual capital structure and cost of debt for the project, both of which are currently unknown. (Staff Objections, pp. 35-37; ALJPO, pp. 135-136)

For all the foregoing reasons, Staff recommends the Commission adopt the ALJPO and reject FutureGen's Exceptions regarding the rate of return provision in the sourcing agreement. If the Commission adopts a sourcing agreement, as the IPA BOE recommends when it proposes the Commission's Final Order include a sentence that states, "[t]he Commission approves this modified Sourcing Agreement, subject to FutureGen and other interested parties providing evidence on appropriate rates of return" (IPA BOE, pp. 9-10), then Staff recommends the Commission adopt Staff's proposed language for Section 5.2(b), which governs the regulatory review and approval of an appropriate rate of return for the project.

C. Staff's Response to NRDC

The ALJPO agreed with Staff and ComEd that an expansion of ComEd's Fridge and Freezer Recycle Rewards program should not be approved as part of the procurement plan because expansion of the program is not cost-effective. (ALJPO, p. 260) NRDC takes exception on this issue. (NRDC BOE, pp. 1, 3-6) The Commission should reject NRDC's arguments and exceptions on this issue. NRDC simply rehashes its past arguments made on this subject that the ALJPO already properly considered and appropriately concluded were "not convincing." (NRDC BOE, pp. 3-6; ALJPO, p. 260)

Staff stands by its original comments filed on this subject, but briefly responds to NRDC's arguments below. (Staff Objections, pp. 56-62; Staff Reply, pp. 29-32) Further, Staff notes that ComEd agreed to exclude the Fridge and Freezer Recycle Rewards program from its proposed portfolio. (ComEd Response, pp. 20-21; ComEd Reply, p. 29)

As an initial matter, NRDC's BOE misconstrues the design of the Fridge and Freezer Recycle Rewards program when it states that the program is "designed to replace customers' refrigerators and freezers with more energy efficient models." (NRDC BOE, p. 3) To clarify, the Fridge and Freezer Recycle Rewards program does <u>not</u> directly encourage higher efficiency replacement or even replacement of the recycled refrigerator at all. In fact, the underlying assumption of the Fridge and Freezer Recycle Rewards program is that the recycled refrigerator will <u>not</u> be replaced: thus, as a result of the program, the customer ends up with fewer refrigerators than they started out with. In short, the Fridge and Freezer Recycle Rewards program does not directly encourage customers to install energy efficient devices. (IPA Plan, Appendix II, ComEd Appendix C-2; Docket No. 10-0570, ComEd Ex. 1.0 Corr., p. 62) With that clarification, Staff now turns to NRDC's arguments and exceptions.

NRDC continues to allege that expansion of the Fridge and Freezer Recycle Rewards program is cost-effective if certain modifications are made to the cost-effectiveness analysis of the program. Despite this assertion, NRDC provides no revised cost-effectiveness calculations to support its claim. Nevertheless, Staff will address each of NRDC's proposed modifications to the cost-effectiveness analysis of the program in turn below.

First, NRDC proposes to include only half the amount paid to customers as a cost in the cost-effectiveness analysis. NRDC argues that treatment of the entire payment made to customers as a cost in the cost-effectiveness analysis leads to an overstatement of societal cost. While NRDC claims this is Staff's proposal, this in fact is not Staff's proposal. As Staff previously clarified in response to NRDC's Response, under Staff's proposal, only a portion of the cost (i.e., reduced by the net-to-gross ratio which is a proxy for customers' value placed on their amenity) is included in the cost-effectiveness analysis. (Staff Reply, pp. 30-31) NRDC has not addressed in its BOE Staff's clarification which the ALJPO agreed was appropriate. (ALJPO, p. 260)

Second, NRDC argues that the program should be screened using three years rather than one year. NRDC claims that a one year analysis of the program does not account for start-up or ramp-up costs that should be spread out over several years. (NRDC BOE, p. 4) As Staff previously pointed out and as the ALJPO properly noted, this program has already gone through a ramp-up period and incurred start-up costs beginning in the June 2008-May 2009 program year. (Staff Reply, pp. 31-32; ALJPO, p. 260) Thus, there are no start-up or ramp-up costs reflected in the cost-effectiveness analysis of this program. Further, considering this program is not being proposed for multiple years as part of this procurement plan filing, it is inappropriate to include multiple years of program implementation costs in the cost-effectiveness analysis. Staff, ComEd, and Ameren[1] all agree that one year screening for the programs proposed for implementation for a single year in this proceeding is appropriate. (ComEd Response, p. 20; Staff Reply, pp. 31-32)

Third, NRDC claims that ComEd[2] understated the avoided costs in its cost-effectiveness analyses. (NRDC BOE, p. 5) ComEd argued that NRDC's recommendations regarding changing avoided cost methodologies were outside the scope of this proceeding because ComEd's cost-effectiveness methodology has been vetted and approved by the Commission in two separate dockets and changing such a well-established methodology would be better evaluated by the Stakeholder Advisory Group which specifically exists for the purpose of vetting issues such as this. Furthermore, NRDC provides no convincing basis for deviating from such precedent. (ComEd Reply, p. 29)

Finally, NRDC's exception is not reflective of the record in this proceeding. NRDC's BOE proposes the following:

> Strike the 3rd full paragraph on page 260 and replace with the following:
>
> The Commission finds that NRDC's position and arguments regarding ComEd's Fridge and Freezer Recycling program are convincing. When that program is analyzed using a three year period, with societal costs set at one half the incentive payment and with use of a marginal line loss analysis, that program is cost effective. The Commission concludes that the Fridge and Freezer Recycle Rewards program should be included in the approved 2013 procurement plan.

[1] Ameren's workpapers for its cost effectiveness calculations use a one-year screening.

[2] In its Objections NRDC also claimed that Ameren understated the avoided costs in its cost-effectiveness analyses. (NRDC Objections, p. 6)

(NRDC BOE, p. 6) Staff contends that there is simply no record support for a Commission conclusion that "When that program is analyzed using a three year period, with societal costs set at one half the incentive payment and with use of a marginal line loss analysis, that program is cost effective." A revised total resource cost ("TRC") test value for this program that incorporates NRDC's modifications to the cost-effectiveness analysis is not part of the record in this proceeding.

III. CONCLUSION

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this docket.

Respectfully submitted,

____
JESSICA L. CARDONI
JOHN C. FEELEY
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
Fax: (312) 793-1556
jcardoni@icc.illinois.gov
jfeeley@icc.illinois.gov

Counsel for the Staff of the
Illinois Commerce Commission

November 29, 2012